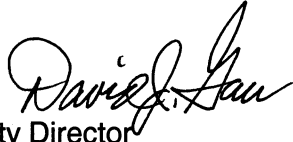


Memorandum

To: Honorable John Chiang, Chair
Honorable Claude Parrish, Vice-Chairman
Ms. Betty T. Yee, Acting Board Member
Honorable Bill Leonard
Honorable Steve Westly

Date: April 25, 2005



From: David J. Gau, Deputy Director
Property and Special Taxes Department

Subject: ***Alternative Cigarette Tax Stamp Project Status Report***

This memorandum is an update on the Alternative Cigarette Tax Stamp (ACTS) Project. On March 15, 2005, I reported that 23 out of a total of 62 cigarette tax stamp application machines have been installed at 13 locations. Additionally, I reported that some installations were taking longer than others because of the new technology; however, we were optimistic that the application machines would be in place by April 30, 2005.

As of April 22, 2005, 49 out of a total of 60^{*} cigarette tax stamp application machines have been installed at 33 locations. These 60 application machines represent approximately 93 percent of the stamp volume that is normally applied by the high-volume application machines. There are nine remaining distributor locations scheduled to receive a cigarette tax application machine, five of which are scheduled for the week of April 25 – April 29. The balance of the cigarette tax stamping, approximately 7 percent, is done by low-volume, hand-stamping machines. To date, 114 low-volume, hand-stamping machines have been purchased and shipped. Additionally, two distributors have decided to discontinue stamping cigarettes and will buy products stamped from one of the major distributors.

The Implementation Plan focused on getting the most new stamps in the marketplace as early in the installation plan as possible given machine availability, distributor needs and competitive issues. Therefore, we focused on the largest distributors and those distributors in the same geographic area. The original plan for the implementation of this project was for the contract award date (approximately July 1, 2004 through December 31, 2004). However, due to the protest and subsequent lawsuit, the implementation could not fully begin until January 2005. As you are aware, the statute did not provide for an implementation period. The initial emergency Regulation 4056.1, *Expiration of Heat-Applied Decal Tax Stamps*, you approved on December 14, 2004 allowed the vendor an extended timeframe to produce and install the necessary machinery and stamps. This timeline (January 2005 through April 2005) was extremely aggressive and two months shorter than the original timeline.

As with any new technology, and coupled with a short implementation period, the number of installations necessary and the entire state as an installation location, there have been some technical difficulties. Each of the machines installed to date is currently operating, but at

^{*}Two distributors decided to discontinue stamping cigarettes and will buy their product from one of the major distributors.

different efficiency levels due to several factors such as machine problems, time in operation since installation, operator familiarity, etc. Specific trouble spots have been identified and addressed or are currently being addressed. Because the situation changes on a daily basis, it is very difficult to list who is running at operational efficiency and who is not. We are in constant communication with the distributors, including the California Distributors Association, and the vendor to make sure that all problems are addressed as timely as possible. The vendor has made a commitment to do what is necessary for the month of May 2005, or until all distributors are operating at the level necessary, and I believe they are making a good faith effort to correct problems as they arise. (Attached is a copy of SICPA's service plan.) Some of the efforts that have been, and are being made to address these issues are:

- Additional staff has been allocated to assist with problems encountered and more staff will be added in May 2005 outside the installation teams.
- Machine modifications and software updates are being made when necessary.
- Service technicians have been placed in facilities that experienced problems meeting operational needs in order to address their issues in a more timely manner.
- Service technicians geographically placed throughout California to timely address any service needs.
- 24-hour service desk to assure that all problems are being addressed as efficiently as possible.

There are three distributors that, due to their own issues, will not have the high-volume cigarette tax stamp application machines installed before April 30th. One distributor did not have the necessary facility modifications completed prior to their scheduled installation date. The second distributor has a sister company that has a high-volume cigarette tax stamp application machine and will be able to meet their production requirements on a temporary basis. The third distributor does such a low volume, that a low-volume, hand-stamping machine will temporarily meet their needs. We also have one distributor who currently has four high-volume cigarette tax stamp application machines and has ordered two additional machines which are scheduled for installation on May 2, but we believe they can meet production needs.

However, even with this effort, it is possible that some locations and some machines may not be running at a desired operational level by April 30, 2005. In order to make sure we do not detrimentally impact any distributor and their business any more than absolutely necessary, we are proposing an extension of the emergency regulation that allows the continued sale of the old stamp for those distributors that need it. Two options are being presented for your consideration. The first is an extension through May 31, 2005. This option provides a minimum amount of time to get all machines installed, and a two-week period to work out any mechanical problems that arise with the last of the installed machines. Staff is recommending this first option because of the commitment from the vendor ensuring all machines are installed and being serviced timely. The second option, an extension through the end of June, is also presented for your consideration. The additional sixty days satisfies any concerns that the May 31 date may not be enough time to ensure that all machines are operating at desired efficiency levels. Also, the June 30 date is consistent with the originally planned six-month implementation plan.

If you have any questions regarding this report, or would like additional information, please call me at 916-445-1516.

Attachment

cc: Ms. Marcy Jo Mandel
Mr. Ramon J. Hirsig

Ms. Kristine Cazadd
Ms. Monica Brisbane

Mr. Dennis Maciel



April 25, 2005

David Gau
Deputy Director
Board of Equalization Property & Special Taxes Dept.
State of California
450 N Street
Sacramento, CA 94279

Dear Mr. Gau;

Attached is a summary of the service plan for May that we have generated with Meyercord that provides details of the resources and geographical coverage effective May 1. You will see that additional resources have been allocated for this crucial period as we endeavor to minimize any downtime incurred by the distributors.

Yours Sincerely,

A handwritten signature in black ink, which appears to read "S. Wass" followed by "(for)" in parentheses. The signature is fluid and cursive.

Stephen Wass
Director, Project Management

ACTS Program – Service Summary for May 2005

Beginning May 1, Meyercord will have 10 dedicated field support personnel in California to perform service as necessary. The team will be comprised of 8 regionally assigned technicians and 2 floating supervisors/technicians for any accounts requiring special attention. We have 2 installations each of the first 2 weeks in May and the installation teams will be independent of the 10 field support personnel. When those installations are completed on May 13th, we will add field personnel as necessary from the installation teams. We intend to keep to this schedule so as to perform additional training, stay on top of machine performance issues and to perform any necessary field modifications.



■ Bay Area Service Region

This region includes 12 stamping machines. Technicians will be in close proximity to major accounts and centrally located with respect to all other Licensed Cigarette Distributor (LCD) equipment placements. Back up will come from the North and South Central Valley Regions as required.

■ North Central Valley Service Region

This region includes 12 stamping machines. Technicians will be based in Merced and Sacramento. Back up will come from the Bay Area and South Central Valley Regions as required.

■ South Central Valley Service Region

This region includes 8 stamping machines. Technicians will be based in Bakersfield and Fresno, and will receive back up from North Central Valley and South Service Regions.

■ South Service Region

This region includes 24 stamping machines in the Los Angeles area. Technicians will be located in San Bernardino and East LA. These locations will be near major accounts and are centrally located within the pattern of remaining LCD equipment installations. Back up will come from the South Central Valley Region and two floating supervisors.

Equipment outside of California will be service by local technicians (NV, AZ, OR).

Technicians will continue to make follow up calls and service visits to each account as required. LCDs will continue to call Meyercord's 24hr service support line for technical assistance, and technician service visits will be scheduled in response to these calls as required.

All technicians will be dispatched by personnel at Meyercord Revenue Headquarters in Carol Stream, IL. The response time goal will be for same day service.

An additional vision system technician will be based in CA during this time, moving from account to account as needed. A second person will be on call as required.

Bay Area Service Region (12)

COSTCO - Tracy
CoreMark - Hayward
PITCO - San Jose
Naser - San Jose
Geary Wholesale - San Francisco
Kurlander - Windsor
Hillman - Napa
Fresh Choice - Benecia

North Central Valley Service Region (12)

CoreMark - Sacramento
McLane - Merced
Bel Air Super Stores - Lathrop
Unified Grocers - Stockton
Albertsons - Roseville
David Candy - Sacramento
C&S Wholesale - Sacramento
MTC - Modesto
CW Brower - Modesto

South Central Valley Service Region (8)

CoreMark – Bakersfield
Valleywide – Bakersfield
Sams Distribution – Fresno
OK Sales – Clovis
E&Z Sales – Visalia
Caramba – Visalia
Rite Aid - Lancaster

South Service Region (24)

McLane - San Bernardino
COSTCO - Mira Loma
CoreMark - Corona
CoreMark - Vernon
Ralphs - Riverside
Kennedy - Irwindale
Cigar Cartel - Sun Valley
Albertsons - LaHabra
Jetro - Vernon
Trepco – San Diego
Statewide – Ontario
Payless - North Hollywood


Others Outside California (4)

CoreMark - Grants Pass, OR
McLane - Goodyear, AZ
Santa Fe Natural - Sparks NV
Franchise Wholesale - LasVegas, NV

M e m o r a n d u m

To : Mr. Ramon J. Hirsig
Executive Director – MIC: 73

Date: April 20, 2005

From : Kristine Cazadd
Chief Counsel 

Subject : Readoption of Emergency Regulation 4056.1, *Expiration of Heat-Applied Decal Tax Stamps*

Chief Counsel Matter – April 27, 2005

I request your approval to submit the attached Readoption of Cigarette and Tobacco Products Tax Regulation 4056.1, *Expiration of Heat-Applied Decal Tax Stamps*, to the State Board of Equalization at the April 27, 2005 meeting to be readopted on an emergency basis.

Background

Senate Bill (SB) 1701, enacted in 2002, added a new section 30162 to the Revenue and Taxation Code. This new statute requires the Board to replace authorized cigarette tax stamps currently in use (i.e., heat-applied decal tax stamps), with a tax stamp that can be read by a scanning or similar device and encrypted with specific information.

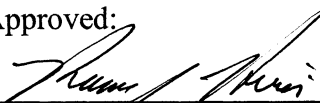
The Board has begun selling the new tax stamp to licensed distributors. However, the sale of new tax stamps must be implemented over an extended period of time, as distributors are in the process of acquiring the appropriate machinery.

Section 30162 does not specifically provide for a transition to the use of the new tax stamp. However, in Section 6 of Statutes 2004, Chapter 822, the Legislature declared that the Board has the authority to implement the changes required by SB 1701 by regulation so that commerce in the state is not negatively impacted. Effective January 1, 2005, Regulation 4056.1 provided for the use of the heat-applied decal tax stamp until April 30, 2005. However, it has been determined that additional time is needed to afford distributors an orderly transition to the new stamp.

The proposed readoption of Regulation 4056.1 will enable distributors to utilize the current

heat-applied decal tax stamp during their transition to the use of the new tax stamp until May 31, 2005. The proposed readoption of Regulation 4056.1 is ready for submittal to the Board under the April 27, 2005, Chief Counsel Matters.

Approved:

A handwritten signature in cursive script, appearing to read "Ramon J. Hirsig", written over a horizontal line.

Ramon J. Hirsig, Executive Director

Regulation 4056.1 Expiration of Heat-Applied Decal Tax Stamps

On and after January 1, 2005, the Board authorizes the continued application of heat-applied decal tax stamps through May 31, 2005 in order to effect the orderly transition from heat-applied decal tax stamps to the new tax stamps required by Revenue and Taxation Code Section 30162, subdivision (a), effective January 1, 2005. Operative June 1, 2005, the Board will no longer sell, or allow for the application of, any cigarette tax stamp other than tax stamps which utilize technology meeting the requirements of Revenue and Taxation Code Section 30162, subdivision (a), effective January 1, 2005.

Note: Authority: Sections 30162 and 30451, Revenue and Taxation Code.

Reference: Sections 30161 and 30162, Revenue and Taxation Code; Section 6 of Statutes 2004, Chapter 822.

FINDING OF EMERGENCY

The State Board of Equalization (Board) finds that the readoption of Cigarette and Tobacco Products Tax Regulation 4056.1, *Expiration of Heat-Applied Decal Tax Stamps*, is necessary for the immediate preservation of the public peace, health and safety, and the general welfare and meets the standards set forth in Government Code Section 11349.1.

The readoption of this regulation is necessary on an emergency basis to avoid any interference with commerce related to the sale of cigarettes within this state on and after the April 30, 2005 expiration date of current Regulation 4056.1. Without the proposed readoption, cigarette distributors will be unable to sell cigarettes, resulting in the loss of income to distributors. Further, if distributors cannot sell cigarettes, there will be a reduction in revenues for the General Fund, Cigarette and Tobacco Products Surtax Fund, and the California Children and Families Trust Fund.

STATEMENT OF SPECIFIC FACTS SHOWING THE NEED FOR IMMEDIATE ACTION

Under the Cigarette and Tobacco Products Tax Law, the Board collects the cigarette excise tax through the sale of tax stamps or meter impressions (hereafter collectively referred to as "tax stamp") to licensed distributors (Rev. & Tax. Code § 30161). All packages of cigarettes sold in this state must bear a tax stamp (Rev. & Tax. Code § 30163). Revenue and Taxation Code section 30162 provides that stamps for affixation to cigarette packages shall be of the designs, specifications, and denominations as prescribed by the Board. The Board prescribes by regulation the method and manner in which tax stamps are to be affixed to packages of cigarettes. The Board may likewise provide by regulation for the cancellation of stamps (Rev. & Tax. Code § 30162). Currently, the tax stamps that the Board sells are heat-applied decal tax stamps.

Senate Bill (SB) 1701, enacted in 2002, added a new Section 30162, effective January 1, 2005. This new statute requires that the Board generate tax stamps by a technology capable of being read by a scanning or similar device and that tax stamps must be encrypted with, at a minimum, the following information: (1) the name and address of the distributor affixing the stamp to the cigarette packages, (2) the date the stamp was affixed, and (3) the denominated value of the stamp.

The Board has begun selling the new tax stamps to licensed distributors in accordance with subdivision (a) of new section 30162. However, the implementation of the new cigarette tax stamps requires distributors to purchase new stamp application machinery. In response to SB 1701 (2002), the Board, in conjunction with the Department of General Services, sought bids for the new tax stamp technology. Due to the resulting time frame for the awarding of the contract and a subsequent protest by one of the bidding parties, the new stamp application machinery was not available to all distributors for conversion to the new tax stamp technology by January 1, 2005. As such, many distributors were not in a position to affix the new tax stamps by the January 1, 2005 effective date.

The provisions of Section 30162(a) do not specifically provide for a transition to the use of the new tax stamp. However, in Section 6 of Statutes 2004, Chapter 822, the Legislature declared that the Board has the authority to implement the changes required by SB 1701 (2002) by regulation so that commerce in the state is not negatively impacted. Based on this authority, the Board adopted emergency Regulation 4056.1, effective January 1, 2005. The regulation will

expire on April 30, 2005. The Board has determined that an additional 30 days is required to ensure that all distributors have the new stamp application machinery and that the machinery is working at required levels.

Unless the proposed regulation enabling distributors to utilize the current heat-applied decal tax stamp beyond January 1, 2005, is readopted, distributors without the new stamp application machinery working at required levels, will be unable to sell any cigarettes, resulting in the loss of income to those distributors. Further, if distributors cannot sell cigarettes, there will be a reduction in revenues for the General Fund (including breast cancer research), the Cigarette and Tobacco Products Surtax Fund (for hospital services, health education, physician services, research and public resources), and the California Children and Families Trust Fund (for early childhood development). In fiscal year 2002-2003 alone, for example, the Board collected approximately one billion dollars in cigarette tax revenue which was deposited directly into these funds. Accordingly, the proposed regulation allows all distributors to continue selling cigarettes, maintaining their income and maintaining state revenues.

AUTHORITY AND REFERENCE CITATIONS

Authority: Section 30451, Revenue and Taxation Code.

Reference: Section 30162, Revenue and Taxation Code; Section 6 of Statutes 2004, Chapter 822.

INFORMATIVE DIGEST

Under the Cigarette and Tobacco Products Tax Law, the Board collects the cigarette excise tax through the sale of tax stamps to licensed distributors. All packages of cigarettes sold in this state must bear a tax stamp. Revenue and Taxation Code section 30162 provides that stamps for affixation to cigarette packages shall be of the designs, specifications, and denominations as prescribed by the Board. The Board prescribes by regulation the method and manner in which tax stamps are to be affixed to packages of cigarettes. The Board may likewise provide by regulation for the cancellation of stamps. Currently, the Board sells heat-applied decal tax stamps.

Senate Bill (SB) 1701, enacted in 2002, added a new Section 30162, effective January 1, 2005. This new statute requires that the Board generate tax stamps by a technology capable of being read by a scanning or similar device and that tax stamps must be encrypted with, at a minimum, the following information: (1) the name and address of the distributor affixing the stamp to cigarette packages, (2) the date the stamp was affixed, and (3) the denominated value of the stamp.

Regulation 4056.1, *Expiration of Heat-Applied Decal Tax Stamps*, is proposed to implement a transition period from the heat-applied decal stamp to the new tax stamp required by Revenue and Taxation Code section 30162, enacted by SB 1701 (Stats. 2002, Ch. 881). Specifically, the regulation will provide for the use of both the heat-applied decal stamp and the stamp specified in Revenue and Taxation Code section 30162(a), effective January 1, 2005, through May 31, 2005.

The regulation provides a transition to the sole use of the new tax stamp, thereby avoiding any disruption to the stream of commerce affecting cigarette distributorship operations and state revenues.

COST TO LOCAL AGENCIES AND SCHOOL DISTRICTS

The State Board of Equalization has determined that the proposed rule does not impose a mandate on local agencies or school districts.

ESTIMATE OF COST OR SAVINGS

The State Board of Equalization has determined that the proposed regulation will not result in any direct or indirect costs or savings to any state agency; any cost to any local agency or school district that is required to be reimbursed under Part 7 (commencing with Section 17500) of Division 4 of Title 2 of the Government Code; any other nondiscretionary costs or savings imposed on local agencies or school districts; or, any cost or savings in federal funding to the state.

Memorandum

To : Mr. Ramon J. Hirsig
Executive Director – MIC: 73

Date: April 21, 2005

From : Kristine Cazadd 
Chief Counsel

Subject : Readoption of Emergency Regulation 4056.1 to June 30th,
Expiration of Heat-Applied Decal Tax Stamps

Chief Counsel Matter – April 27, 2005

I request your approval to submit the attached Readoption of Cigarette and Tobacco Products Tax Regulation 4056.1, *Expiration of Heat-Applied Decal Tax Stamps*, to the State Board of Equalization at the April 27, 2005 meeting to be readopted on an emergency basis.

Background

Senate Bill (SB) 1701, enacted in 2002, added a new section 30162 to the Revenue and Taxation Code. This new statute requires the Board to replace authorized cigarette tax stamps currently in use (i.e., heat-applied decal tax stamps), with a tax stamp that can be read by a scanning or similar device and encrypted with specific information.

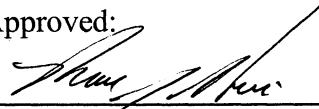
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Section 30162 does not specifically provide for a transition to the use of the new tax stamp. However, in Section 6 of Statutes 2004, Chapter 822, the Legislature declared that the Board has the authority to implement the changes required by SB 1701 by regulation so that commerce in the state is not negatively impacted. Effective January 1, 2005, Regulation 4056.1 provided for the use of the heat-applied decal tax stamp until April 30, 2005. However, it has been determined that additional time is needed to afford distributors an orderly transition to the new stamp.

The proposed readoption of Regulation 4056.1 will enable distributors to utilize the current

heat-applied decal tax stamp during their transition to the use of the new tax stamp until June 30, 2005. The proposed readoption of Regulation 4056.1 is ready for submittal to the Board under the April 27, 2005, Chief Counsel Matters.

Approved:

A handwritten signature in black ink, appearing to read 'Ramon J. Hirsig', written over a horizontal line.

Ramon J. Hirsig, Executive Director

Regulation 4056.1 Expiration of Heat-Applied Decal Tax Stamps

On and after January 1, 2005, the Board authorizes the continued application of heat-applied decal tax stamps through June 30, 2005 in order to effect the orderly transition from heat-applied decal tax stamps to the new tax stamps required by Revenue and Taxation Code Section 30162, subdivision (a), effective January 1, 2005. Operative June 1, 2005, the Board will no longer sell, or allow for the application of, any cigarette tax stamp other than tax stamps which utilize technology meeting the requirements of Revenue and Taxation Code Section 30162, subdivision (a), effective January 1, 2005.

Note: Authority: Sections 30162 and 30451, Revenue and Taxation Code.

Reference: Sections 30161 and 30162, Revenue and Taxation Code; Section 6 of Statutes 2004, Chapter 822.

FINDING OF EMERGENCY

The State Board of Equalization (Board) finds that the readoption of Cigarette and Tobacco Products Tax Regulation 4056.1, *Expiration of Heat-Applied Decal Tax Stamps*, is necessary for the immediate preservation of the public peace, health and safety, and the general welfare and meets the standards set forth in Government Code Section 11349.1.

The readoption of this regulation is necessary on an emergency basis to avoid any interference with commerce related to the sale of cigarettes within this state on and after the April 30, 2005 expiration date of current Regulation 4056.1. Without the proposed readoption, cigarette distributors will be unable to sell cigarettes, resulting in the loss of income to distributors. Further, if distributors cannot sell cigarettes, there will be a reduction in revenues for the General Fund, Cigarette and Tobacco Products Surtax Fund, and the California Children and Families Trust Fund.

STATEMENT OF SPECIFIC FACTS SHOWING THE NEED FOR IMMEDIATE ACTION

Under the Cigarette and Tobacco Products Tax Law, the Board collects the cigarette excise tax through the sale of tax stamps or meter impressions (hereafter collectively referred to as "tax stamp") to licensed distributors (Rev. & Tax. Code § 30161). All packages of cigarettes sold in this state must bear a tax stamp (Rev. & Tax. Code § 30163). Revenue and Taxation Code section 30162 provides that stamps for affixation to cigarette packages shall be of the designs, specifications, and denominations as prescribed by the Board. The Board prescribes by regulation the method and manner in which tax stamps are to be affixed to packages of cigarettes. The Board may likewise provide by regulation for the cancellation of stamps (Rev. & Tax. Code § 30162). Currently, the tax stamps that the Board sells are heat-applied decal tax stamps.

Senate Bill (SB) 1701, enacted in 2002, added a new Section 30162, effective January 1, 2005. This new statute requires that the Board generate tax stamps by a technology capable of being read by a scanning or similar device and that tax stamps must be encrypted with, at a minimum, the following information: (1) the name and address of the distributor affixing the stamp to the cigarette packages, (2) the date the stamp was affixed, and (3) the denominated value of the stamp.

The Board has begun selling the new tax stamps to licensed distributors in accordance with subdivision (a) of new section 30162. However, the implementation of the new cigarette tax stamps requires distributors to purchase new stamp application machinery. In response to SB 1701 (2002), the Board, in conjunction with the Department of General Services, sought bids for the new tax stamp technology. Due to the resulting time frame for the awarding of the contract and a subsequent protest by one of the bidding parties, the new stamp application machinery was not available to all distributors for conversion to the new tax stamp technology by January 1, 2005. As such, many distributors were not in a position to affix the new tax stamps by the January 1, 2005 effective date.

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expire on April 30, 2005. The Board has determined that an additional 30 days is required to ensure that all distributors have the new stamp application machinery and that the machinery is working at required levels.

Unless the proposed regulation enabling distributors to utilize the current heat-applied decal tax stamp beyond January 1, 2005, is readopted, distributors without the new stamp application machinery working at required levels, will be unable to sell any cigarettes, resulting in the loss of income to those distributors. Further, if distributors cannot sell cigarettes, there will be a reduction in revenues for the General Fund (including breast cancer research), the Cigarette and Tobacco Products Surtax Fund (for hospital services, health education, physician services, research and public resources), and the California Children and Families Trust Fund (for early childhood development). In fiscal year 2002-2003 alone, for example, the Board collected approximately one billion dollars in cigarette tax revenue which was deposited directly into these funds. Accordingly, the proposed regulation allows all distributors to continue selling cigarettes, maintaining their income and maintaining state revenues.

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Authority: Section 30451, Revenue and Taxation Code.

Reference: Section 30162, Revenue and Taxation Code; Section 6 of Statutes 2004, Chapter 822.

INFORMATIVE DIGEST

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The regulation provides a transition to the sole use of the new tax stamp, thereby avoiding any disruption to the stream of commerce affecting cigarette distributorship operations and state revenues.

COST TO LOCAL AGENCIES AND SCHOOL DISTRICTS

The State Board of Equalization has determined that the proposed rule does not impose a mandate on local agencies or school districts.

ESTIMATE OF COST OR SAVINGS

The State Board of Equalization has determined that the proposed regulation will not result in any direct or indirect costs or savings to any state agency; any cost to any local agency or school district that is required to be reimbursed under Part 7 (commencing with Section 17500) of Division 4 of Title 2 of the Government Code; any other nondiscretionary costs or savings imposed on local agencies or school districts; or, any cost or savings in federal funding to the state.